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STEPHEN R. ROSS

October 1, 1993

HAND-DELIVERED

William F. Caton
Acting Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

Re: **Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 - Rate Regulation**
MM Docket No. 92-266

Dear Mr. Caton:

Enclosed on behalf of the Medium-Sized Operators Group, are the original and four copies of the Group's Comments in the above-referenced proceeding.

Please address any questions concerning these Comments to the undersigned.

Cordially,

Stephen R. Ross

SRR/sdb
Enclosures

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the matter of:	)	
Implementation of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-266
Rate Regulation	)	

COMMENTS OF THE MEDIUM-SIZED OPERATORS GROUP

Adelphia Communications Corporation
Bresnan Communications Company
Cablevision Systems Corp.
Columbia International, Inc.
Falcon Cable TV
Hauser Communications
InterMedia Partners
Jones Spacelink, Ltd.
Lenfest Communications, Inc.
Marcus Cable
Prime Cable
RP Companies, Inc.
Simmons Communications, Inc.
Star Cablevision Group
Sutton Capital Associates
Triax Communications Corp.
United Video Cablevision, Inc.
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Dated: October 1, 1993

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Before the
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In the Matter of	)	
	)	
Implementation of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-266
	)	
Rate Regulation	)	

COMMENTS OF THE MEDIUM-SIZED OPERATORS GROUP

The medium-sized operators group[1] (the "Group"), by its attorneys, hereby submits the following comments on the Federal Communications Commission's ("FCC or Commission") Third Notice of Proposed Rulemaking, ("NPRM") FCC 93-428, MM Docket No. 92-266 (released August 27, 1993) on cable television rate regulation.

The Group's members operate cable television systems which together represent more than 25% of the total cable television subscribers in the United States, and are directly affected by the proposed regulations. Accordingly, the following comments are respectfully submitted in response to the Commission's NPRM in the above-referenced proceeding.

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[1] The members of this group include: Adelphia Communications Corporation, Bresnan Communications Company, Cablevision Systems Corp., Columbia International, Inc., Falcon Cable TV, Hauser Communications, InterMedia Partners, Jones Spacelink, Ltd., Lenfest Communications, Inc., Marcus Cable, Prime Cable, RP Companies, Inc., Simmons Communications, Inc., Star Cablevision Group, Sutton Capital Associates, Triax Communications Corp., United Video Cablevision, Inc., and US Cable Corporation.

I. INTRODUCTION

In general, the Group supports the FCC's efforts to modify the benchmarks to more accurately reflect the costs associated with operating a cable television system. The Group acknowledges the extremely difficult task assigned to the Commission by Congress, and the impossibly short time frame in which to complete these proceedings. While the Group urges the Commission to address the concerns discussed herein, it is difficult to provide specific, meaningful comments on the treatment of certain costs and their relation to the benchmark rate levels when the FCC has placed the cable industry on notice that a forthcoming Second Order on Reconsideration may yet substantially revise the fundamental benchmark formula. NPRM at ¶ 4, n.7 ("One of the potentially significant issues under review, for instance, is whether the number of regulated satellite channels on a given system is an appropriate variable in setting the system's rates.") Given the lack of finality with respect to the benchmarks themselves, the lack of cost-of-service standards, and the interrelationship between benchmarks and cost-of-service regulation, the Group's position on issues addressed herein may be modified in the future.

II. ADDITION AND DELETION OF PROGRAMMING CHANNELS

A. The Current Benchmark Rates Do Not Compensate Cable Operators for the Costs of Programming

The Third NPRM identifies three alternative proposals with respect to the treatment of programming costs associated with the addition or deletion of programming channels. NPRM at ¶¶ 133 - 144. By these proposals, the FCC implicitly acknowledges that the benchmarks, in their current form, do not compensate cable operators for the costs of programming. In particular, the FCC's tentative rejection of its present rule, described as its second alternative (i.e., determining the permitted rate by multiplying the new number of channels by the benchmark rate), expressly acknowledges that the benchmarks "create substantial disincentives for cable operators with rates above the benchmark to add channels." Id. at ¶ 138.

In its Supplemental Comments, the Group provided the FCC with Ernst & Young's ("E&Y") examination of the actual costs of eight (8) recent rebuilds completed by certain of the Group's members. The actual rebuild costs per channel per subscriber compared with the additional revenue per channel permitted under the benchmarks left these eight systems with margins, before programming costs, marketing and overhead costs, of between -$0.09 to $0.08. See, Supplemental Comments filed August 4, 1993, E&Y Report attached thereto at Section 2(C). Therefore, based on factual information provided by the Group and other cable operators, and the FCC's own analysis, the benchmarks may compensate some operators in part for the capital costs of providing video signals, but they do not compensate any cable operators for: (1) the cost of programming; (2) all of the cost of equipment and labor required to add such channels[2]; (3) a reasonable profit; (4) or the advertising and administrative costs of marketing new programming services.

Because benchmark rates do not compensate cable operators for the existing cost of programming, much less provide any incentive to add quality programming, the Group continues to believe that the actual programming cost for each additional satellite channel must be treated as external to the benchmark price cap. See, Supplemental Comments, supra, at p.4.

B. The FCC's Programming Cost Proposal

Based on the foregoing, the Group questions the FCC's expressed preference for the so-called third programming alternative because such alternative will result in only a modest increase in the permitted rate above the present benchmark rates, and because it will still not totally compensate cable operators for their actual capital and programming costs, thereby forcing cable operators into cost-of-service showings in order to justify the cost of additional programming channels. Specifically, the FCC's third proposal requires cable operators to first subtract their prior average direct programming cost from the prior benchmark rate, and to then reduce the result from this calculation by the same percent that the benchmark rate for the new combined number of channels declines from the benchmark rate

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[2] For example, the cost of equipment and installation for adding a single channel ranges from $4,000 to $5,000 per headend, assuming that a currently received satellite delivers the new channel.

for the prior number of channels, all of which determines the "adjusted base rate." To this adjusted base rate, operators are to add their new average programming cost per channel (measured over the combination of both old and new satellite channels) in order to determine the new permitted benchmark rate. NPRM at ¶ 143.

In addition to the fundamental non-compensatory nature of the benchmark formula, one of the major problems with this proposal is that it requires operators to average only their total direct satellite programming costs over their entire number of regulated channels, which channels include satellite as well as non-satellite channels such as must-carry and retransmission consent signals and public, educational and governmental ("PEG") access channels. However, the non-satellite channels all have both direct and indirect costs associated with them, such as copyright royalty fees, retransmission consent fees and PEG access costs, none of which are included in the cost-side of the programming cost calculation. As a consequence, the average per channel cost of programming under the FCC's proposal is substantially diluted due to the averaging in of channels that have no direct programming costs, but which nevertheless do have substantial non-programming costs associated with them.

For example, consider an existing cable system owned by one of the Group members which has a total of 26 regulated channels, 16 of which are satellite channels which have direct programming costs totalling $2.23. This particular cable system has 1,752 subscribers and a current benchmark rate of $19.99 for all 26 channels (or $0.769 per channel). The average per channel cost of programming for the existing 26 channels is $0.086.

Suppose the operator adds three satellite channels costing an average of $0.05 per channel. Using the FCC's proposal, the operator would first subtract its prior average programming cost of $0.086 from the prior permitted base rate per channel of $0.769. The resulting number of $0.683 would then be reduced by the 8.32% reduction in the benchmark rate for 29 channels compared to the benchmark rate for 26 channels, to arrive at an "adjusted base rate" of $0.626. Finally, the operator would add its new average programming cost of $0.082 (i.e., $2.23 plus $0.15, divided by 29 channels) to the adjusted base rate of $0.626 to determine its new permitted base rate of $0.708. As a consequence of those several calculations, in this case the FCC's proposal would result in a total permitted rate for all 29 channels of $20.53, which represents an increase of only $0.08 over the FCC's present benchmark rate for 29 channels of $20.45, which increase is de minimis and insufficient to correct the inequity implicit in the present approach, which inequity the Commission has identified and acknowledged.

Using the same system characteristics, suppose the cable operator adds instead three channels with programming costs equal to the $0.20 average per channel cost prevalent in the industry. In this case, the operator adds the new average cost of programming of $0.097 ($2.23 plus $0.60, divided by 29 channels) to the adjusted base rate of $0.626 to determine a new base rate per channel of $0.723 for a total permitted rate for all 29 channels of $20.97 (which represents an increase over the FCC's prior total permitted benchmark rate of $19.99 of just $0.98). Thus, after incurring an additional $0.60 in direct programming costs, the cable operator is permitted to recover only $0.126 per channel for capital costs, administration and profit. As the Group indicated in its Supplemental Comments, supra, eight cable systems owned by Group members recently spent between $0.07 and $0.27 per channel for rebuild capital expenditures alone.

Averaging the cost of direct satellite programming costs over the entire number of regulated channels is illogical and equivalent to blending apples with oranges. Moreover, the FCC's proposal does not include a mechanism for cable operators to add a reasonable profit on cable programming costs, nor does it account for advertising and administrative costs. Most significantly, however, the Group has provided substantial evidence that the current benchmark rates do not permit operators to recover the average costs of programming. See, Supplemental Comments, supra. Accordingly, the Group maintains that the programming costs for additional channels should be treated as external to the FCC's benchmarks.

III. UPGRADES INITIATED BEFORE REGULATION

The Group agrees with the FCC that operators with below-benchmark rates that recently initiated or completed upgrades should be permitted to raise their rates to benchmark levels without a cost-of-service showing. NPRM at ¶145. As the FCC now recognizes, it is a common practice in the cable industry to phase in rate increases following a system upgrade or rebuild. Not having anticipated the dramatic re-regulation of cable rates, many operators initiated modest rate increases with the expectation that their capital expenditures would be recovered over time. Therefore, allowing such operators to increase their rates to the benchmark is both reasonable and imperative.

However, the FCC's proposal does not go far enough. As the Group stated in its Supplemental Comments filed on August 4, 1993 in this proceeding, cable operators that completed upgrades and rebuilds after September 30, 1992 are particularly penalized. The Group offered a specific example of the "Worksheet 5 problem" where a system that completed a rebuild after September 30, 1992 obtained a maximum permitted rate (after completing Worksheets 1, 2, and 5) of $22.52 for 42 channels. Using the identical system information, the Worksheets were then completed as if the operator had completed the rebuild before September 30, 1992, in which case the maximum permitted rate for all 42 channels becomes $24.33. Simply by completing the rebuild before September 30, 1992, the operator would be permitted to charge an additional $1.81 per subscriber per month. See, Group's Supplemental Comments, Ernst & Young Paper, Attachment 1.

In its Supplemental Comments, the Group proposed that for operators which completed upgrades or rebuilds and initiated rate increases after September 30, 1992, and where rates are above the benchmark (which requires the completion of Worksheet 2), line 201 should be completed using currently effective rates. The remainder of Worksheet 2 would be completed without change.[3] For purposes of this proposal, the Group suggests that the FCC define "upgrade" or "rebuild" as:

> any construction that increases channel capacity, consolidates headends, replaces coaxial cable with fiber cable, or converts the system to addressability or results in capital expenditures for distribution, labor and material that exceeds the average capital expenditure for distribution, labor and material for the previous two years by 25%.

The Group believes that this transitional rule should also apply to cable operators which were hindered in their ability to increase their rates following the completion of a rebuild as a result of the FCC's Freeze Order.[4] Such operators should be permitted to use the "post-rebuild" rate in line 201. This small change, applicable only to a small number of cable operators caught in the transition from an unregulated to a regulated environment, would at least allow such operators to make rate reductions based on post-rebuild rates, rather than on pre-rebuild rates.

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[3] Using currently effective rates in Worksheet 2 would obviate the need to complete Worksheet 5.

[4] 8 FCC Rcd. 2921, clarified, 8 FCC Rcd. 2917 (1993).

IV. DISCRETION TO SELECT BENCHMARKS OR COST-OF-SERVICE FOR DIFFERENT REGULATED TIERS

As the Group stated in its Comments in the Commission's cost-of-service rulemaking, operators should be permitted to choose between benchmarks and cost-of-service for different regulated tiers. Where rates for one or more regulated tiers are at or below the benchmark, providing cost information for those tiers is unnecessary and would be administratively burdensome for the cable operator, the franchise authorities, and the Commission. As the Commission itself recognizes, requiring cable operators to elect either benchmarks or cost-of-service for all regulated tiers will encourage more cost-of-service showings and will force operators to conduct the same rate case before two different regulatory bodies. NPRM at ¶ 147. In contrast, allowing operators to provide cost-of-service justifications only for above-benchmark rates in certain but not all tiers, would further the Commission's goal of streamlining the rate regulatory process.

Nevertheless, the FCC tentatively concludes that operators must select the same option for all regulated tiers based on its fear of potential abuse by operators "gaming" the process, despite the fact that there is no evidence in the record to support such a conclusion. Id. at ¶ 148. In any event, if the FCC wishes to eliminate incentives to such so-called "gaming," it is not necessary to eliminate entirely the operator's option to choose cost-of-service for only one regulated tier. The FCC can simply adopt a rule that requires an operator to show that its costs for <u>all regulated tiers</u> are higher than the permitted benchmark rate, and then allow an operator to proceed with a cost-of-service showing only for those tier(s) for which the operator wishes to justify increased rates.

For example, an operator whose basic tier costs were less than the permitted benchmark rate would be precluded from making a cost-of-service showing for only the cable programming tier. In this scenario, such a operator should be required to conduct cost-of-service showings for <u>all</u> regulated tiers in order to prove that it is not "gaming" the system. If, however, an operator's costs are above the benchmark rate for all regulated tiers, then there is no incentive for gaming. Allowing operators the discretion in such instance to choose cost-of-service for less than all regulated tiers would provide an incentive to forego the cost and administrative effort required for a cost-of-service showing for a tier that has few subscribers and/or only marginally higher costs than the benchmark rate, and would allow the operator to pursue a single cost-of-service showing before only one regulatory body.

V. UPGRADES REQUIRED BY FRANCHISE AUTHORITIES

The Group supports the Commission's proposal to allow cable operators to permit external cost treatment for upgrades required by the franchise authority. NPRM at ¶ 153. However, external treatment should not be limited only to upgrades required by franchising authorities, but rather such treatment should be available for any upgrade required by any authority.

As the Group stated in its Supplemental Comments filed in the benchmark reconsideration proceeding, the benchmarks do not adequately account for the capital costs associated with upgrades and rebuilds. As noted above, on average, the cost of rebuilding a system, including the cost of addressable converters, is approximately $600 per subscriber. The cost is approximately $130 to $250 per subscriber to electronically upgrade a system. These figures do not include the cost of programming or the increased costs of compliance with the 1992 Cable Act, including customer service standards, new technical standards, and retransmission consent fees.[5] The incremental rates per additional channel permitted under the FCC's benchmarks are substantially less than just these capital costs. Therefore, external treatment should be afforded for capital improvements, regardless of whether they are imposed at the local, state or federal level.

The Group maintains that it would be confiscatory for the FCC to allow any authority to impose upgrade requirements on cable operators without affording cable operators the ability to recover the substantial capital costs of upgrades through rates charged to subscribers. Mandatory costs imposed by any local, state or federal regulatory body should be recoverable in the

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[5] The FCC's benchmarks also do not account for the costs of complying with the Americans with Disabilities Act, which requires closed-captioning on public access channels. It is estimated that it will cost each system between $25,000 - $70,000 for the necessary equipment, and $250 - $450/hr. for qualified captioners.

regulated entity's rate base. As the Group stated in its comments filed in the cost-of-service proceeding, the 1992 cable technical standards and customer service requirements will require some operators to upgrade from coaxial cable to fiber optics. Since the substantial majority of such costs enhance the essential distribution plant, they are properly allocable, in whole or in large part, to the regulated tiers. See, Comments of the Medium-Sized Operators' Group, MM Docket No. 93-215, August 25, 1993, at p.26-27. Thus, external treatment should be afforded not only to upgrades and rebuilds required by the franchise authority, but also for all government-mandated capital improvements required by the Commission and/or the 1992 Cable Act or by any regulatory body.

Moreover, operators should not be required to bear the administrative costs of producing full cost-of-service showings to account for mandatory upgrades and rebuilds. Such costs should be afforded external treatment and streamlined procedures should be adopted by the Commission to guide franchise authorities in reviewing the cost-based showings associated with rebuilds. The Group does not believe that franchise authorities should determine the standards by which such cost-based showing are reviewed. Rather, the FCC must adopt uniform federal standards applicable to all showings.

VI. CONCLUSION

As discussed above, the FCC's proposed modification to the present benchmark approach to account for the higher cost of satellite programming will not be a sufficient adjustment to the benchmarks to compensate operators for their actual costs. The most equitable and least administratively burdensome mechanism by which to account for the increased cost of satellite programming would be to simply allow operators to treat the cost of new satellite channels in the same manner that increases in existing satellite programming costs will be treated -- namely, as external to the price cap.

In addition, operators that have recently rebuilt their systems should be afforded an opportunity to recover at least part of their capital costs through the transitional rule discussed above. The FCC should not limit relief only to operators with below benchmark rates. As shown above, FCC Form 393 unfairly penalizes operators which upgraded or rebuilt their systems after September 30, 1992. Allowing such operators to use their currently effective rates in line 201 of Worksheet 2 will alleviate the unintended penalties inherent in the current rule.

Moreover, allowing operators to choose between cost-of-service and benchmarks for different regulated tiers, as discussed above, will be an effective means of streamlining the cost-of-service process.

Finally, operators must be permitted to recover in their subscriber rates all of the costs of compliance with various local, state, and federal requirements.

Based on the foregoing, the Group respectfully requests that the Commission adopt the proposals discussed herein.

Respectfully submitted,

THE MEDIUM-SIZED OPERATORS GROUP

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Dated: October 1, 1993

CERTIFICATE OF SERVICE

I, Susan Benson, a secretary of the law office of Ross & Hardies, do hereby certify that I have this 1st day of October, 1993, served by hand a copy of the foregoing "Comments of the Medium-Sized Operators Group" to:

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By: ______________________
Susan Benson